VZCZCXRO0666
PP RUEHAG RUEHDF RUEHIK RUEHLZ RUEHROV RUEHSR
DE RUEHRL #1685/01 3540931
ZNR UUUUU ZZH
P 190931Z DEC 08
FM AMEMBASSY BERLIN
TO RUEHC/SECSTATE WASHDC PRIORITY 2881
INFO RUCNMEM/EU MEMBER STATES COLLECTIVE PRIORITY
RUCNFRG/FRG COLLECTIVE PRIORITY
RUEHDF/AMCONSUL DUSSELDORF PRIORITY 0169
RUEHFT/AMCONSUL FRANKFURT PRIORITY 7802
RUEHAG/AMCONSUL HAMBURG PRIORITY 0237
RUEHLZ/AMCONSUL LEIPZIG PRIORITY 0173
RUEHMZ/AMCONSUL MUNICH PRIORITY 1961
RUEHC/DEPT OF LABOR WASHINGTON DC PRIORITY
RUEATRS/DEPT OF TREASURY WASHINGTON DC PRIORITY

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STATE FOR EEB(NELSON),EEB/OMA(SAKAUE, WHITTINGTON),
DRL/ILCSR AND EUR/AGS
LABOR FOR ILAB(BRUMFIELD)
TREASURY FOR ICN(KOHLER),IMB(MURDEN,MONROE,CARNES) AND OASIA
SIPDIS

E.O. 12958: N/A
TAGS: EFIN ECON PREL GM
SUBJECT: THE GERMAN CREDIT CRISIS: HOW BAD IS IT?

REF: A. BERLIN 1476
¶B. BERLIN 1677

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¶1. SUMMARY. German businesses and banks are debating whether or not there is a credit crisis in Germany. There is no shortage of anecdotes about companies facing credit constraints. The picture is in fact mixed: many large, industrial firms are having problems securing credit at reasonable prices, whereas small- and medium-sized enterprises (SMEs) are either self-financing or having less trouble. As the recession deepens, however, even smaller German firms could have problems getting loans. The German government and European Central Bank are intervening to help keep credit circulating in the economy. END SUMMARY.

DEBATE OVER CREDIT CRUNCH

¶2. Since the financial crisis reached Germany this fall, fears of a credit crunch have grown. Anecdotes abound. A BMW representative complained to ConGen Munich representatives that his company recently had to borrow at an extraordinary 600 basis points above the bank rate. Citing high refinancing costs, Volkswagen's financial affiliates applied for loan guarantees from the government,s 500 billion euro bank rescue fund ("SoFFin") (REF A). MAN's Chief Financial Officer told a German newspaper, "There is definitely a credit crunch," and blamed financing difficulties for declining truck sales. The company has taken steps to help its customers finance the purchase of new trucks. According to the Financial Times, the global container shipping industry, 36 percent of which is German-owned, is having trouble getting essential letters of credit, preventing many ships from even leaving port. Nevertheless, Deutsche Bank CEO Josef Ackermann recently told Bavarian television, "There is no credit crisis in Germany." He added that German banks had increased the amount of credit they grant by 13 percent over the past year. Whom should we believe?

LARGE FIRMS ARE SUFFERING

¶3. The answer may depend in part on the borrower. A survey by the Munich-based Ifo, one of Germany's premier economic institutes, found a disparity between large firms and small- and medium-sized enterprises (SMEs). Four in ten large

German companies saw tighter access to credit in November, more than double the number in August. Far fewer SMEs reported problems. Ulrich Klueh, head of the Scientific Staff at the German Council of Economic Experts, told ConGen Frankfurt Econoff that banks were hoarding funds to boost their capital in the face of significant write downs.

¶4. A separate report by BDI -- a German lobby group representing large, industrial concerns -- is consistent with Ifo's findings, concluding its members are having more trouble obtaining credit. One-third of respondents reported problems, and fully two-thirds complained of deteriorating credit terms, including increased loan guarantee premiums and tougher disclosure requirements. Among those surveyed, the automotive, steel and metal processing, paper, engineering, construction, shipbuilding and ceramics industries had the most problems.

¶5. Many lending institutions are operating under difficult circumstances. A recent Bundesbank survey shows that half of responding German banks had tightened lending standards on their clients since 2007 by, for example, increasing loan margins, lowering credit ceilings, and reining in credit lines. Many of those surveyed explained that tighter conditions in international money and bond markets were key factors ultimately influencing the terms they could offer clients. The study found that since the financial crisis began, the cost of equity financing had more than doubled, spreads on commercial bonds had soared, and the market for commercial paper had dried up. Respondents to the Bundesbank survey confirmed loan terms were more restrictive for certain sectors, such as the automobile industry. Many also reported the slowing economy was having a secondary effect on lending, as companies faced liquidity problems thanks to lower

revenues. DIHK representatives told Embassy Berlin EMIN that banks were having trouble finding buyers for securitized debt.

SMES ARE DOING BETTER

¶6. Small- and medium-sized enterprises (SMEs) -- which account for 90 percent of all German companies -- are having few funding problems. Axel Nitschke, Executive Director of the German Chambers of Industry and Commerce (DIHK), told Embassy Berlin EMIN that many middle-sized firms are self-financing, so they need little if any outside funding. Smaller firms tend to borrow more often, but usually need relatively small amounts, which are readily available from the cash-flush savings banks ("Sparkassen"). The German savings bank association DSGV reports that savings banks actually increased the volume of loans they made to SMEs by 10.5 percent in the first three quarters of 2008, compared with the same period last year. A representative of the Hesse and Thueringen Savings Bank Association likewise noted lending by members in his region was up 40 percent on the year. Unlike large commercial and state banks, savings banks generally have no direct exposure to exotic financial assets, and maintain a high level of tier 1 capital. They are not going through a painful process of "deleveraging" like larger commercial and state banks.

¶7. DSGV said it expects lower loan volume in the future as a result of the recession. SMEs, some of which are integral parts of larger firms' supply chains, will increasingly suffer from collapsing global demand. Demand for loans from savings banks will likewise decrease.

IN SEARCH OF NORMALCY

¶8. Economists note a healthy financial sector is a prerequisite for economic growth. Keen to ensure German banks can lend, the German government created SoFFin, its 500

billion euro bank rescue fund (REF A). It has also launched a 12 billion euro fiscal stimulus plan to boost demand in the wider economy, and is considering a second wave of measures (REF B). For its part, the European Central Bank (ECB) has attempted to keep funds circulating by lowering its main policy rate, as well as the rate it pays on sums parked with it overnight by banks. It is considering creating a &clearing house8 to overcome distrust between banks in order to boost the interbank lending market.

¶9. Some observers think more needs to be done. For example, the government could loosen SoFFin's strict conditions to encourage more participation by Germany's troubled state banks. The government could also move quickly on a second, larger stimulus to boost demand. Many would like to see the ECB set its main policy rate far lower than it has been willing to do thus far. Critics of the "clearing house" idea contend that high borrowing costs are attributable to the increased risk that lending banks themselves face rather than to distrust, and question the wisdom of the ECB's approach. Calls for more intervention will likely grow louder as economic conditions deteriorate, putting more pressure on the authorities to act.

¶10. ConGens Frankfurt and Munich provided input for this cable.
Koenig